College Planning Challenges and the Role of 529 Plans

A View from Higher Education: What Can Colleges Do to Help Families Plan and Save for College and Minimize Debt?

What are the major challenges today and what do we anticipate in the future?
What is the value of a college education?

(Greetings)

Everyone agrees that college is expensive — and getting more expensive every year. As college costs go up, so too does the burden of student debt. There's been a lot of hand-wringing, but very few solutions offered. For the past couple of decades, the topic of college affordability has been a bit like the weather — everyone talks about it, but no one, it seems, can do anything about it.

Unfortunately, I'm afraid we're at a tipping point, and the time for action is now. I say this because tuition levels have increased so much and require so much borrowing that the entire student financial aid system, particularly the loan programs are structurally unworkable. The amounts borrowed are simply too large to be manageable under repayment schedules which are too short. If you doubt this, consider that more than 60% of the student loans are in default or are not being repaid under their original terms.

What happens when the price of a college education becomes prohibitive for most American families and they haven't planned for this major expense? Kids drop out. Students default on student loans. And our national economy suffers.

HOW WE GOT HERE: WHICH CAME FIRST HIGH TUITION OR HIGH STUDENT DEBT, POORLY DESIGNED FEDERAL PROGRAMS AND UNINTENDED CONSEQUENCES?

Since becoming a college president people ask me: How come college costs so much? What are you doing about the huge amount of debt the students are racking up?

There are many explanations of how we arrived at 41 million student borrowers with close to $1.3 trillion in student loans. Let me give you three theories that many espouse—the three “Bs:” Bowen, Baumol and Bennett.

Some blame Bowen--Howard Bowen to be specific--a former College President--who came up with **Bowen’s Rule** that said that the purpose of higher education is excellence, prestige, and influence. Striving for excellence is on target.

But this philosophy has been misinterpreted and has led too many colleges to miss the mark, leading to ever higher and higher tuition bills.

Some colleges interpreted him to mean that there should be virtually no limit to the amount of money that should be spent to pursue excellence and prestige. So, they decided to raise and spend as much money as possible and to encourage students to borrow as much as possible to pay for best professors (a good idea), a wide array of student services, ranging from helpful tutors, to not so essential party planners and of course, the big-ticket amenities. Somewhere along the way, probably after Bowen's death, Bowen's Rule became higher education's Card Blanche or in this case Card Bowen which helped launch the amenities war.

THE AMENITIES WAR

Since the quality of a higher education degree is hard to measure, Bowen and those who came after him, made tuition price the proxy for quality.

If it costs a lot it must be worth it. Bowen's Rule justified raising tuition to appeal to parents' quest for prestige and spending the tuition revenue war chests on lavish amenities was necessary to attract students. Colleges started providing ever more elaborate amenities. And what a contest it has become!

The amenities have even attracted the attention of Congress and not in a good way. One report cited the 2,100 gallon aquariums with pretty fish; first run movie theaters with free snacks; Olympic sized, heated swimming pools; indoor rivers for swimming upstream and waterfalls; indoor tracks, multiple-court gyms and fitness centers with hundreds of state-of-the-art exercise machines, and climbing walls.

At Washington College, we've decided to take a different approach:

We froze tuition last year and are increasing scholarships, increasing access for a more diverse and inclusive group of students and working on ways to reduce the need for student borrowing and ways to guarantee that students will always have an affordable payment when they graduate. I will give you details of all our affordability initiatives before I conclude my remarks.

As for quality, we measure it in many ways with an emphasis on outcomes—quality of life after graduation, satisfaction and career opportunities after graduation; ability to afford life's milestones with a manageable amount of student debt.

COLLEGE COSTS INCREASED MUCH FASTER THAN CPI; COLLEGES HAVE

DIFFICULTY INCREASING PRODUCTIVITY BUT MUST MATCH WAGES WITH SECTORS THAT CAN INCREASE PRODUCTIVITY

Baumol's Cost Disease is another theory for explaining increased higher education costs. The economist, William Baumol, attributes the rising tuition prices on the lack of productivity growth in higher education. "Colleges and universities are "labor-intensive enterprises, relying on highly skilled professors to provide essentially the same service that colleges have provided for decades." Colleges have no choice but to match comparable salaries with sectors of the economy that have benefited from productivity gains. And colleges have to compete with other colleges for professors. This phenomenon results in a growing cost of labor, bigger operational budgets and thus ever-higher tuition prices.

However, faculty pay HAS NOT been a primary driver of tuition increases. I only wish our professors had seen their salaries increase as much as tuition—and so do they!

But I do think Baumol is on to something. By its very nature — small class sizes, hands-on learning opportunities, robust support services, and a residential learning environment — a liberal arts education is particularly expensive. Washington College is a school with the equivalent of 1,465 full time students and 125 full-time equivalent faculty for a student to faculty ratio of 11.7 to 1. While we endeavor to spend smarter, we cannot sacrifice the quality of education that our students have come to expect. Private liberal arts colleges have the highest graduation rates and lowest loan default rates among the higher education sector. I believe this is because we deliver excellence and value.

The third and most important B is for Bennett.

The Bennett Hypothesis named after former Education Secretary Bill Bennett, postulated that increasingly generous federal financial aid policies have pushed tuition upwards. According, to this theory, larger Pell grants, increased availability of student loans and higher borrowing limits have fed the growing demand for college degrees and given colleges a steady source of revenue which has enabled them raise tuition year after year. The Bennett Hypothesis has the New York Fed backing it up as recently as last month:

- They found that a dollar increase in federal aid meant that tuition and accompanying fees rose by:

    - 65 cents-on-the-dollar for Direct Subsidized Loans;
    - 50 cents-on-the dollar for Pell Grants; with
    - Little or no effect on Federal Direct Unsubsidized Loans

The transition to direct federal lending was well intentioned - to make college financing more widely available. Unfortunately, it has proven to have serious unintended consequences as loans are being made to students and families who have little hope of repaying them. We have seen a decline in the quality and effectiveness of loan counseling, total absence of underwriting, perverse incentives resulting from flaws in the federal government contracting process for loan-servicing, and the consequences of allowing institutions of higher education—including those with poor student outcomes—to act as loan originators."

These flawed federal policies have incentivized and facilitated the student loan borrowing binge and have contributed to the increasing default rates.

And no list of cost drivers would be complete without mentioning regulation and unfunded mandates. Colleges must hire staff and retain counsel to administer federally mandated services, to fill out federally mandated reports and comply with thousands of pages of regulations. I sincerely hope that the Trump regulatory reform initiative looks carefully at higher education regulations. As a start, it would be a tremendous help to eliminate those regulations that have absolutely nothing to do with higher education. I would happily dedicate any savings to funding additional scholarships!

Some of these trends are outlined in a study, published today by the Bipartisan Policy Center entitled "Higher Education Trends: Rising Costs, Stagnant Outcomes, State Incentives."

TUITION INCREASES OUTPACED CPI

When you consider Bowen, Baumol and Bennett together it is easier to understand why during the past several decades, college costs have risen at a rate of 7% a year, much faster than average inflation. Since 1985, the overall consumer price index has risen 115%, while the college education inflation rate has risen nearly 500%!

I am proud to say that Washington College has done a relatively good job of trying to navigate this difficult environment. Our tuition increases have generally been smaller than at peer institutions, and our student default rates are among the lowest in the country.

CURRENT STUDENT LOAN DEBT LEVELS

So where does this leave us?

In 2015, the average debt for graduates from all four-year institutions was $30,100 nationally (Project on Student Debt).

Nationally, 69% of all students incur debt and 77% of students from low income families borrow compared to 50% of students from high income families (Pew Research Center). First generation students usually must borrow more and do so at higher interest rates.

When I became President of Washington College in 2015, I was talking about $1.2 trillion in outstanding student loans, and 18 months later we are looking at close to $1.3 trillion.

PARALLELS BETWEEN HOUSING CRISIS AND THE STUDENT DEBT CRISIS

This explosion of student debt holds disturbing parallels to the subprime mortgage frenzy which led to the 2008 financial cataclysm. Both are fueled by well-intentioned, but poorly designed government policies to promote laudable social goals. Both have perversely led to an increase in the cost of attaining those goals. Both reflect a proliferation of loans to borrowers who have little chance of repaying them. And both promise to be a drag on economic growth for years to come.

With the easy availability of mortgage debt, we made owning a home more expensive but ultimately did little to improve home ownership rates. Similarly, with easily available student loans, we've helped make college generally more expensive, but the percentage of high school students going to college hasn't really moved much.

We are up to $1.3 trillion in debt, and what are we getting for it? The comparison of real wage growth for college graduates compared to the rise in student debt levels is startling. Drawing from the research by the New York Fed and data published by the U.S. Department of Education, one Huffington Post analysis showed that real wages for the typical college graduate have risen only 1.6% over the last 25 years, while average student debt for four-year graduates has grown by a whopping 163.8%. I cannot fathom the devastating effect on our young people and on our national economy if this trend continues.

A COLLEGE IS WORTH IT

Yet, for all that, a college degree is still an investment that pays strong dividends given the decline in wages of those who do not have it. According to a recent study published by the Federal Reserve Bank of New York, the return on a college degree has held steady for more than a decade at around 15%, "easily surpassing the threshold for a sound investment." That same study found that "workers with a bachelor's degree on average earn well over $1 million more than high school graduates during their working lives, while those with an associate's degree earn about $325,000 more."

A liberal arts degree represents not only a bigger paycheck, but also an insurance policy of sorts. We don't know what the jobs of tomorrow will look like, but we do know that those jobs will require creative, nimble thinkers. The most valuable employees will be strong communicators and problem-solvers who are able to quickly adapt to the changing demand of our global, tech-driven economy. They surely will be called upon to assimilate new knowledge and adapt to new situations. They won't need to have all the answers, but they will need to know how to ask the right questions.

Where does all this leave today's generation? Between a rock and a hard place. They need something they can't afford, and they are willing to borrow dearly to pay for it — often to their detriment. This problem doesn't affect just low- and middle-income families. It goes far up the income ladder, impacting virtually everyone but the super-rich. And having a negative long-term effect on our economy.

WASHINGTON COLLEGE'S MULTI-FACETED APPROACH

What's to be done? Here at Washington College, we're using a multi-faceted approach to help average Americans pay for college and alleviate the burden of student debt. Let me share some details.

The **George's Brigade** initiative — which promises to meet the full financial needs of recruited students, including room and board — allows high-need, high-potential students to apply to our school in small, self-selected groups, so that they can be admitted with friends who will share in their transition to college life. We knew that we would have to raise additional scholarship money and then put the infrastructure in place to support our George's Brigade scholars to ensure their success at our college. We partnered with local community organizations to help identify and recruit highly motivated groups of students who could benefit from a small liberal arts school experience, and looked to the faculty and staff to help develop avenues for leadership training, career mentoring, and social integration into the fabric of the College community.

In its first year, we have 14 students from around the country as the first George's Brigade scholars, and we have secured funding to support 20 additional Brigade students entering this fall. To date, fundraising efforts total more than $3.7 million for the program's endowment, as well as $1.5 million in current-use scholarships. Over 150 students have applied for our 20 Brigade scholarships for next year - showing the need for all of us to do more.

Dam the Debt is intended to help students reduce their federally-held student loan debt as they graduate. Last May, through the generosity of individual and institutional donors, 119 qualifying seniors received grants totaling $313,000 to offset those loans. In December 2016, Dam the Debt reduced another $22,000 in federally subsidized loans for eight graduating seniors from five states. Amounts vary depending upon the students' loans, but the average reduction was $2,750. That's about 10% of their federal student debt load, and a good first step as we strive to help our students graduate and enter the world financial flexibility. Imagine how much our young work force could fuel our national economy, unhindered by excessive student debt!

A couple of months ago, we announced **FixedFor4,** a fixed-rate tuition plan that will hold tuition constant for four years. For families on a tight budget, annual tuition increases sometimes make remaining in college financially untenable. FixedFor4 gives them the security of knowing precisely how much their undergraduate degree will cost — guaranteed. That's true regardless of whether the current economic worries about increasing inflation hold true. With FixedFor4, even as other costs may go up, we will protect families from tuition hikes.

And we are rewarding parents who have consistently saved for their children's college education. The **Saver's Scholarship** matches any withdrawal from a 529 plan or ESA that is used to pay tuition at Washington College up to $2500 a year. We believe we are the only college offering this, but we hope that many other institutions will follow our lead. I hope you will help me get the word out! And in the meantime, encourage parents and students to look at Washington College.

And thank you for all the work you do getting the word out about the benefits of 529 plans. You have created some excellent websites with valuable information and tools to compare plans, estimate annual contributions needed to achieve college savings goals, and importantly, to compare fees.

I like 529s and ESAs because the minimum contribution is very low which makes them an excellent savings mechanism for almost all families in all income brackets. The tax treatment of 529s has been more generous—more favorable—and more essential—to encourage families to save for college.

I am glad to see in your new **Strategic Insight study** that 529s are being used by every income bracket from $25,000 to $150,000.

You have all probably heard the story about Albert Einstein being asked to name the most powerful force in the universe and his answer—"compounding interest, compounding earnings." If he were asked today, he might say the benefit of compounding tax free in a 529 plan or ESA.

A few months ago, I testified before Congress in the Ways and Means Committee and my advice to everyone in the audience was, "if you have children, start saving for college now. . ." That was good advice, but better advice would have been: "start saving for college now, and one of the best way to save for college is with a 529 plan or an ESA." Parents and grandparents should open 529 plans and ESAs before a baby is even brought home from the hospital and contributions, regardless of size, should be made every year to take advantage of compounding and the tax deferred growth.

So, why doesn't everyone with college bound children have a 529 plan or an ESA? Why aren't they harnessing the tax favored power of compounding in a 529 plan?

The annual parents and students saving survey, conducted by our conference hosts, the College Savings Foundation, suggests that too many parents and students simply don't know about them.

The survey underscores how vital the College Savings Foundation's mission is to help families better <u>understand</u> how to save for their children's higher education. It is my mission and it is your mission, too. Thank you for the work you do.

There is an interesting story about why I wanted to create this program at Washington College. As you may know I have written a best seller about the financial crisis, but you may not know that I also wrote a children's book called "Rock, Brock and the Savings Shock." It is about the benefits of regularly saving money and the miracle of compounding.

At a book signing, a parent announced to me, very loudly, and defiantly, that she was not saving for college and had advised her son not to save for college because he would not be entitled to as much financial aid.

Her comment haunted me and when I became President of Washington College, I decided that I would reward personal responsibility, foresightedness and saving through our 529 Savers' Scholarship.

I'll continue to beat the drum for college affordability, and I'm grateful to have this organization in my corner, educating the public about the importance of saving for college. This is a fight for the future of our nation, and for the strength of our economy. But this is a battle worth fighting. The pressure on higher education budgets will surely continue. It is up to all of us to save more, to spend smarter, to find new sources of revenue, and to make sure that the nation's best and brightest students can afford the best private liberal arts college experience we can offer.